IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Statesboro Division

IN RE: THOMAS E. MCKINNEY JR. SHIRLEY R. MCKINNEY Debtors	)	CHAPTER 7 CASE NUMBER 09-60495
DURDEN BANKING COMPANY INC. Plaintiff	)	
vs.	)	ADVERSARY PROCEEDING NUMBER 10-06017
THOMAS E. MCKINNEY JR. SHIRLEY R. MCKINNEY Defendants	)	

MEMORANDUM OPINION AND ORDER DENYING DISCHARGE

This matter came on for trial on the Complaint Objecting to Discharge and to Determine Dischargeability of Debt filed by Durden Banking Company Inc. ("Durden Banking") against Debtors Thomas E. McKinney Jr. and Shirley R. McKinney.[1] Having considered the stipulated facts, testimony, and documentary evidence, I conclude that neither Thomas McKinney nor Shirley McKinney is entitled to a discharge under 11 U.S.C. § 727.

[1] Only Shirley McKinney appeared at trial.

FINDINGS OF FACT

Thomas and Shirley McKinney operated East State Equipment Company Inc. ("ESEC"), a business that sold used construction, logging, and farming equipment. Thomas McKinney was the CEO, a director, and the majority stockholder of ESEC. Shirley McKinney was the Secretary, an office she had held since at least 2001. She also was the bookkeeper—fulltime for three years from 2005, then parttime from 2008, after she took a job teaching in the local elementary school.

Shirley McKinney took the teaching job because the McKinneys wanted health insurance under the school district's group policy, which cost significantly less than what the McKinneys had been paying for coverage. Thomas McKinney has longstanding and serious health problems, including diabetes, heart disease, and leukemia. These problems impair his thinking at times.

In June 2009, the McKinneys and ESEC separately filed for relief under chapter 11 of the Bankruptcy Code. In re McKinney, Case No. 09-60495 (Bankr. S.D. Ga. filed June 2, 2009); In re East State Equipment Co., Inc., Case No. 09-60494 (Bankr.

S.D. Ga. filed June 2, 2009).[2] In April 2010, both cases were converted to cases under chapter 7.

At the time the cases were filed, the McKinneys personally owed two notes to Durden Banking and were guarantors on three other notes owed by ESEC. All of the notes were cross-collateralized and secured by three deeds to secure debt, five individually identified pieces of heavy equipment, and a blanket security interest in all of ESEC's fixtures, equipment, inventory, and accounts receivable. On the date of the bankruptcy filings, ESEC and the McKinneys owed Durden Banking a total of $955,239.37. (Ex. P-1, Schedule of Note Balances and Deficiency Computation.) The amount still owed after liquidation of all available collateral, excluding interest, is $545,522.46. (Id.)

Many items of collateral were not available to liquidate, however, as Durden Banking realized after entry of an order granting relief from the automatic stay (ESEC Dkt. No. 75.) Of the fifty-two pieces of equipment owned by ESEC at the time the bankruptcy cases were filed, twenty-two are still missing ("Missing Equipment"). The Missing Equipment is worth $472,572.50. (Ex. P-47, Spreadsheet - Schedule of Equipment.) The unaccounted-for items include tractors, motor graders, bulldozers, pavers, and other large pieces of heavy equipment.

[2] References to the docket in the McKinneys' case appear in this format: "McKinney Dkt. No. ___." References to the docket in ESEC's case appear in this format: "ESEC Dkt. No. ___." References to the docket in this adversary proceeding appear in this format: "A.P. Dkt. No. ___."

The central—and unanswered—question in this adversary proceeding is what happened to the Missing Equipment.

I.

Conflicting Testimony and Omissions from ESEC's Schedule B by Thomas McKinney

Thomas McKinney gave conflicting testimony about the Missing Equipment. Because Thomas McKinney did not appear at trial, the following transcripts were admitted into evidence: testimony taken under oath at the § 341 meeting of creditors ("341 Meeting") and at the Rule 2004 examination ("Rule 2004 Exam"). Also admitted was the review copy of the Rule 2004 Exam transcript on which Thomas McKinney made hand-written changes.

When questioned at the Rule 2004 Exam, Thomas McKinney gave detailed answers concerning the location, condition, and value of each of the twenty-two items of Missing Equipment. (Ex. P-91 at 55 - 64, 66-69, 73-78, 80-84, 87.) Five months later at the 341 Meeting, he gave different answers as to seventeen of the items. (Ex. P-90 at 10-11, 15-19, 23-32, 34-39, 44.)

For example, Thomas McKinney testified at the Rule 2004 Exam that a Hitachi Ex-200 C-5 Excavator, valued on ESEC's Schedule B at $40,000, was on ESEC's land in Screven County, Georgia. (Ex. P-91 at 55:5-16.) When asked about this same piece of equipment at the 341 Meeting, however, Thomas McKinney testified that the Excavator should not have been listed on

ESEC's schedules and that it was owned by Dan Boyd in Albany, Georgia. (Ex. P-90 at 14:24-19:16.) Not only did this statement conflict with Thomas McKinney's prior testimony, it also conflicts with ESEC's chapter 11 Plan & Disclosure Statement, which listed the Excavator. (See ESEC Dkt. No. 93-1 at 2.)

Similarly, Thomas McKinney testified at the Rule 2004 Exam that a 58P Komatsu Crawler Tractor w/Rope & 6 Way Blade, valued on ESEC's Schedule B at $45,000, was located at ESEC's business premises in Swainsboro, Georgia. (Ex. P-91 at 63:19-25.) When asked about this same piece of equipment at the 341 Meeting, however, Thomas McKinney testified that ESEC did not own such a tractor. (Ex. P-90 at 27:6-23.) Not only did this statement conflict with Thomas McKinney's prior testimony, it also conflicts with ESEC's chapter 11 Plan & Disclosure Statement, which listed the Komatsu. (See ESEC Dkt. No. 93-1 at 2.)

Thomas McKinney further testified at the Rule 2004 Exam that ESEC owned six pieces of equipment that he did not list on ESEC's Schedule B. (Ex. P-91 at 66-67, 80-84, 87.) Based on his testimony as to the value of each piece, the total value of the equipment omitted from Schedule B is $188,500.00. (Id.)

Five pieces of the omitted equipment are on the list of Missing Equipment. As to these five pieces, Thomas McKinney's testimony at the Rule 2004 Exam conflicted with his later testimony at the 341 Meeting, when he either disclaimed ESEC's

ownership or testified that he didn't remember what happened to the equipment. (Ex. P-90 at 34-39, 44.)

Thomas McKinney wanted to make sweeping changes to his earlier testimony long before the 341 Meeting, however. Less than one week after the Rule 2004 Exam, he received a copy of the transcript to review, with an errata sheet attached for his corrections. He wrote on the errata sheet that his changes were "too numerous to list on this page" and that he had marked them on each individual page. (Ex. P-92 final unnumbered page.)

Of the 122 transcript pages, 32 include Thomas McKinney's handwritten changes. The changes are substantive and extensive. For example, every word on page 63 and all but 6 lines on page 64 are completely marked through. (Ex. P-92 at 16.) The marked-through questions and answers concern a 2000 John Deere 200 hydraulic excavator, a 58 Komatsu crawler tractor, and a Gallion 7500A motor grader, all of which are among the Missing Equipment. In addition to multiple other mark-throughs, Thomas McKinney annotated numerous lines on many other pages with "confused" and "mistaken." (Ex. P-92 at 5, 14-16, 18, 20-23, 26.) He signed his marked-up review copy on January 21, 2010, a date approximately two weeks after the date of his testimony.

II.

Inaccurate Monthly Operating Reports by Shirley McKinney

Also relevant to the question of the Missing Equipment is the accuracy of the eleven Monthly Operating Reports filed during the pendency of ESEC's case under chapter 11. All of the Monthly Operating Reports were signed by Shirley McKinney, who declared by her signature under penalty of perjury that each Monthly Operating Report ("MOR") and its supporting documents were true and correct to the best of her knowledge and belief.

But according to credible testimony by Durden Banking's forensic accountant, supported by his expert witness report, the MORs are not true and correct. As related particularly to the reporting of inventory, the inaccuracies include:

(1) In the initial MOR for June 2009, the inventory balance at the petition date is shown as $602,087.94, which is the exact amount of total personal property reported on ESEC's Schedule B. However, that amount on Schedule B includes accounts receivables of $600.00, whereas the June 2009 MOR shows accounts receivables of $25,600.00. (P-89, Report of William R. Hickman Jr., CPA, CFF, 2-3.)

(2) The inventory balance shown on the initial MOR does not include the value of six pieces of equipment that were omitted from Schedule B but acknowledged by Thomas McKinney in the Rule

2004 Exam as belonging to ESEC. (P-89 at 3.) According to McKinney's testimony, those items are worth a total of $188,500.00. (P-91 at 80-84, 87.)

(3) In the MOR for July 2009, the inventory report shows $3600.00 of inventory purchased, but there are no corresponding payments in the check register. (P-89 at 3.)

(4) In the MOR for September 2009, the inventory report shows adjustments or write-downs of $21,856.50. This figure is unexplained. (Id.)

(5) In the MOR for January 2010, the explanation in the inventory report of the $27,500.00 adjustment or write-down as "sold in Dec '09" is inaccurate, as that amount would have been reflected in the MOR for December 2009. (P-89 at 4.)

These inaccuracies make the MORs useless in accounting for the Missing Equipment. Moreover, the discrepancy between the inventory that should have been reported in the MORs and the inventory that actually was reported is staggering. Based on ESEC's bankruptcy schedules, Thomas McKinney's testimony at the Rule 2004 Exam, and known purchases and sales, ESEC should have had at least $528,015.41 of inventory remaining as of April 30, 2010, the day the case was converted. (Test. W. Hickman.) The MOR for April 2010, however, shows inventory as of that date to be zero. (Ex. P-66.)

CONCLUSIONS OF LAW

Durden Banking argues that the debt the McKinneys owe is excepted from discharge under 11 U.S.C. § 523 (a)(4) ("for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny") and § 523(a)(6) ("for willful and malicious injury by the debtor to another entity or to the property of another entity"). Durden Banking also argues that the McKinneys should be denied a discharge under § 727(a)(2), (a)(3), (a)(4)(A), (a)(4)(D), (a)(5), and (a)(7). Because I agree that § 727 applies based on the evidence before me, the arguments under § 523 are moot.[3]

A finding against the debtor under any one subsection of § 727(a) is a sufficient ground for denial of the discharge. Protos v. Silver (In re Protos), 322 Fed. Appx. 930, 932-33 (11th Cir. 2009). Because discharge is denied to Thomas McKinney and to Shirley McKinney under § 727(a)(7) through acts committed under § 727(a)(4)(A), I do not reach the question of whether discharge should be denied under any other subsection.

I.

Section 727(a)(7)

A discharge shall be granted unless:

> (7) the debtor has committed any act specified in paragraph (2), (3), (4), (5),

[3] The § 523 arguments were moot as to Thomas McKinney before the trial began, because he already had waived the discharge of his indebtedness to Durden Banking. (See McKinney Dkt. No. 187.)

> or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case under this title or under the Bankruptcy Act, concerning an insider . . . .

11 U.S.C. § 727(a)(7). When the debtor is an individual, the term "insider" includes "[a] corporation of which the debtor is a director, officer, or person in control." 11 U.S.C. § 101(31)(A)(iv). When the debtor is a corporation, "insiders" include the debtor's directors and officers; the person in control of the corporation; or a relative of a director, officer, or person in control. 11 U.S.C. § 101(31)(B)(i), (ii), (iii), (vi).

Here, the parties stipulated that ESEC is an insider of the McKinneys and the McKinneys are insiders of ESEC. (A.P. Dkt. No. 33 at 17.) Consequently, the McKinneys' actions under § 727(a)(4)(A) during the pendency of their case and in connection with ESEC's case supply the ground for denial of discharge under § 727(a)(7).

II.

Section 727(a)(4)(A)

> A discharge shall be granted unless:
>
> (4) the debtor knowingly and fraudulently, in or in connection with the case—
>
> (A) made a false oath or account . . . .

11 U.S.C. § 727(a)(4)(A). Denial of discharge under this subsection requires the plaintiff to prove the following elements:

> (1) the debtor made a statement under oath; (2) the statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with fraudulent intent; and (5) the statement related materially to the bankruptcy case.

Stamat v. Neary, 635 F.3d 974, 978 (7th Cir. 2011). Not only false statements but also deliberate omissions may result in denial of a discharge. Chalik v. Moorefield (In re Chalik), 748 F.2d 616, 618 (11th Cir. 1984). The subject matter of an omission or false statement is material if "it bears a relationship to the bankrupt's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property." Id.

"A debtor's petition, schedules, statement of financial affairs, statements made at a 341 meeting, testimony given at a Federal Rule of Bankruptcy Procedure 2004 examination, and answers to interrogatories all constitute statements under oath for purposes of § 727(a)(4)." Freelife Int'l, LLC v. Butler (In re Butler), 377 B.R. 895, 922 (Bankr. D. Utah 2006). A signature on a monthly operating report also implicates § 727(a)(4). Walton v. Williamson (In re Williamson), 414 B.R. 895, 901 (Bankr. S.D. Ga. 2009).

Because denial of a debtor's discharge is an extraordinary remedy, courts construe exceptions to discharge under § 727 liberally in favor of the debtor and strictly against

the objecting party. E. Diversified Distribs., Inc. v. Matus (In re Matus), 303 B.R. 660, 671 (Bankr. N.D. Ga. 2004). The objecting party bears the initial burden of establishing the basis of the objection. In re Chalik, 748 F.2d at 619. The burden then shifts to the debtor to come forward with credible evidence to overcome the inference of knowledge and fraudulent intent. In re Matus, 303 B.R. at 677. If the debtor fails to come forward with such evidence, the inference is not overcome and denial of discharge is warranted. Gen. Steel, Inc. v. Farris (In re Farris), No. 06-00059, 2008 WL 4830309, at *42 (Bankr. N.D. Ala. 2008). The objecting party bears the burden of proof by a preponderance of the evidence. Stamat, 635 F.3d at 978.

A. Thomas McKinney

Durden Banking established the basis of its objection as to Thomas McKinney by demonstrating that he failed to list six items on ESEC's Schedule B that he identified as belonging to ESEC in his Rule 2004 Exam, and further, that Thomas McKinney's testimony at the Rule 2004 Exam conflicted with his later testimony at the 341 Meeting. The inescapable conclusion is that Thomas McKinney testified falsely either at the Rule 2004 Exam or at the 341 Meeting. In addition, he either misrepresented the equipment owned by ESEC when he signed the Schedule B or he gave false testimony regarding the location, condition, and value of the equipment in his later testimony. The false testimony and

omissions from Schedule B are material because they relate to the existence of assets in ESEC's bankruptcy estate.

The false testimony and the omissions give rise to the inference that Thomas McKinney knowingly and with fraudulent intent attempted to obscure assets and thereby hinder the efforts of Durden Banking to locate and liquidate its collateral. The inference is strengthened by Thomas McKinney's attempt to change his initial testimony by extensive "corrections" to the transcript of the Rule 2004 Exam.

At this point, the burden would shift to Thomas McKinney to overcome the inference with a credible explanation of his conduct. Thomas McKinney having not appeared at trial to testify, however, the inference is not overcome. Accordingly, Durden Banking has proved its case as to Thomas McKinney under § 727(a)(4)(A) by a preponderance of the evidence. Denial of discharge is therefore warranted.

B. Shirley McKinney

Durden Banking established the basis of its objection as to Shirley McKinney by demonstrating that a number of the MORs she signed in ESEC's bankruptcy case included incorrect information concerning the value of ESEC's inventory. As pertaining to ESEC's assets, the value of inventory is material. The burden then shifted to Shirley McKinney to overcome the inference that she

signed the MORs with the knowledge they were inaccurate and with fraudulent intent. Shirley McKinney failed to carry this burden.

The gist of Shirley McKinney's testimony at trial was that she performed only simple bookkeeping tasks, did not know anything about ESEC's inventory, and appropriately trusted Thomas McKinney to supply the inventory values that were included in the MORs. She argued on this basis that she did not knowingly and fraudulently make a false oath when she signed the inaccurate MORs.

The U.S. Trustee urges in an amicus brief that Shirley McKinney's argument is without merit. I agree.

"[A]n honest error or mere inaccuracy is not a proper basis for denial of discharge." In re Butler, 377 B.R. at 922. But reckless indifference to the truth, meaning "not caring whether some representation is true or false," has long been treated as the functional equivalent of fraud under § 727(a)(4)(A). Id. at 922-23 (internal quotation marks omitted); see also Boroff v. Tully (In re Tully), 818 F.2d 106, 111 (5th Cir. 1987)("A debtor cannot, merely by playing ostrich and burying his head deeply enough in the sand, disclaim all responsibility for statements which he has made under oath.").

Here, Shirley McKinney was recklessly indifferent to the truth of the inventory figures in the MORs, as the following testimony shows:

Q: Now, you prepared this [inventory report in the June 2009 MOR] from information given to you by whom?

A: Tommy.

Q: And did you do anything to verify that those numbers were accurate?

A: No, because I had never done inventory at all, period.

Q: You just blindly accepted the numbers that he [Thomas McKinney] gave you.

A: I am married to him.

. . . .

Q: Did you ever ask to look at that physical inventory list?

A: No.

Q: You never attempted to compare that physical inventory list with the numbers appearing on this report?

A: No, I did not.

. . . .

Q: Did you ask Mr. McKinney to explain how these numbers were arrived at?

A: No, that wasn't my job.

(Test. S. McKinney.) That Shirley McKinney simply trusted the information Thomas McKinney supplied, without any independent investigation, is "inconsistent . . . with the actions of an honest and truthful debtor who takes [her] obligations under the Bankruptcy Code seriously," In re Butler, 377 B.R. at 927.

Moreover, Shirley McKinney's trust was especially misplaced because she knew Thomas McKinney was mentally impaired as a result of his health problems:

> Q: Have you noticed any changes in his behavior since he's gotten sick?
>
> A: His hemoglobin stays low and he is extremely tired. He doesn't function well. If his diabetes is out of whack, he doesn't think straight. If it's low, he is in a daze, doesn't know what's going on. For instance, last night it was 29, in the middle of the night. And he had no clue where he was or what he needed to do. That happens frequently. It goes up to three or four hundred, it's the same thing. He just doesn't function like he normally should. He can't think straight.
>
> Q: Has he been acting rationally the last couple of years?
>
> A: At times he does not . . . .

(Test. S. McKinney.) As the U.S. Trustee correctly concluded in his amicus brief, "[t]hat [Shirley] McKinney would place blind faith in her husband's representations under these circumstances, without undertaking even a minimal effort to verify the information he provided her, constitutes a blatant disregard of her oath." (A.P. Dkt. No. 44 at 4.)

Durden Banking thus has proved its case as to Shirley McKinney under § 727(a)(4)(A) by a preponderance of the evidence. Denial of discharge is therefore warranted.

CONCLUSION

Durden Banking having met its burden of proof for denial of discharge under § 727 as to each of the Debtors, discharge is denied as to both.

ORDER

IT IS THEREFORE ORDERED that the discharge of the debts of Thomas E. McKinney Jr. is **DENIED** under 11 U.S.C. § 727 (a)(4)(A) and (a)(7) and

FURTHER ORDERED that the discharge of the debts of Shirley R. McKinney is **DENIED** under 11 U.S.C. § 727 (a)(4)(A) and (a)(7).

A separate judgment will be entered as required under Rule 58 of the Federal Rules of Civil Procedure, made applicable in this adversary proceeding by Rule 9021 of the Federal Rules of Bankruptcy Procedure.

JOHN S. DALIS
United States Bankruptcy Judge

Dated at Brunswick, Georgia,
this 14 day of March, 2012.